



STATE OF NEW MEXICO  
*Educational Retirement Board*

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November 30, 2010

The Honorable Luciano "Lucky" Varela, Chairman  
Legislative Finance Committee  
325 Don Gaspar, Suite 101  
Santa Fe, NM 87501

Dear Representative Varela,

The purpose of this letter is to express ERB's concerns regarding the discussion draft bill (LCS ref # .183038.2SA) that would repeal the ERB's exemption to the procurement code for investment services.

If this bill is passed, it would severely hamper the continued implementation of several successful ERB investment programs including private equity, real estate, infrastructure, and natural resources. It would be impossible to continue these current programs if we were required to issue RFP's for the selection of managers. A prime example of success in these programs is private equity, which has made significant contributions to investment performance with a return of 24% in the last twelve months. This return has been a result of the current process, which has allowed the ERB to take advantage of unique opportunities available in the marketplace. This flexibility would not exist under an RFP process, resulting in mediocre returns at best. Please see the attached document entitled "December 1, 2010 IOC Meeting, Presentation of ERB Private Equity Selection Process" for further details.

I realize that this is an attempt to address the legislative concerns regarding investment procurement issues that have taken place in the last few years. We share the public's and your concern about these issues and believe safeguards were indeed necessary to prevent future occurrences. We feel these safeguards are now in place.

The first important change was the passage of Miguel Garcia's HB 876 in 2009. This bill created a new statute, 22-11-54, requiring the disclosure of third-party marketers involved in acquiring New Mexico investments. Any person who knowingly withholds

this information is guilty of a fourth degree felony, punishable by a fine and imprisonment.

In addition to the new law, ERB adopted a comprehensive Placement Agent Disclosure Policy effective December 2009 built around and incorporating the statute. A copy of the policy is attached and has been posted on the ERB website since its adoption. In summary, it requires substantial disclosure of information for placement agents involved in investments contemplated by ERB. Among other items, these requirements include a description of all communications between the manager and placement agent regarding a potential ERB investment and a complete disclosure of all compensation agreements. Relevant information gathered under this policy is shared with the ERB Investment Committee at the public meeting where the potential investment is discussed and voted upon. Subsequently a summary of placement agent information will be reported in the quarterly performance reports of the fund. The first report will be included in the December 31, 2010 report as this will be the first instance of placement agent involvement since the policy was adopted. These reports are publically available and will also be posted to the ERB website.

In addition, contracts with investment managers put in place since the adoption of new policies and procedures include both the provisions of the previously mentioned statute and policy. Contract provisions not only outline the required disclosures but also contain substantial contractual penalties for non-compliance.

We did not stop there, however. In reviewing the "lessons learned" from recent history, one of the weaknesses identified was that the ERB relied solely upon its private equity consultant, Aldus, to gather and disclose placement agent information. Even though Aldus was under a contractual obligation to provide the information; they either did not disclose the information or provided incorrect information. As a result, ERB will no longer rely solely on a consultant. The contracts with consultants will still require consultants to gather and disclose information and will in fact contain substantial penalties for failure to accurately do so, in addition to citing the criminal penalties in section 22-11-54. In addition, ERB staff will independently gather placement agent information as a double check and additional safeguard.

In addition to concerns about the impact of the draft bill on ERB's investment process, the bill also gives rise to concerns from a legal standpoint as to how the bill would affect the professional service contracting process. Other agencies might note additional concerns in other areas of procurement.

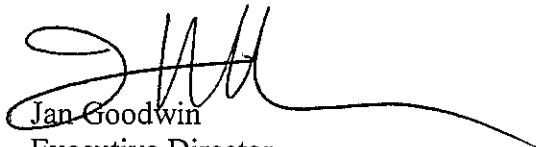
The bill would amend Section 13-1-172 to permit anyone aggrieved in connection with the award of a sole source or emergency procurement contract to protest that award. Emergency procurements are allowed when a threat to public health, welfare, safety or property exists. Section 13-1-127 NMSA 1978. Allowing protests to the award of such contracts would delay responses to emergencies. The proposed amendment to Section 13-1-172 would allow it to be used to thwart the emergency procurement process that Section 13-1-127 creates. It also would encourage vendors who were not selected to file

protests, regardless of whether the protest has any merit. Rather than amending Section 13-1-172 to prevent abuses, Section 13-1-128 should be amended to require the State Auditor to annually review and issue a public report on emergency procurements. That review would be in addition to reporting such procurements to the Legislative Finance Committee, as the draft bill would require. Any additional action needed to address questionable use of the emergency procurement process could then be tailored to address actual problems encountered if necessary. While allowing protests to the award of a sole source contract gives rise to some concern, allowing such protests does not have the same effect it does with emergency contracts. The audit process outlined above, however, would be better suited to reviewing such contracts and, if necessary, drafting legislation or rules to address actual problems encountered.

The draft bill also would add a new subparagraph (E) to Section 13-1-126 providing that the sole source procurement provisions shall not be circumvented by "narrowly drafting specifications so that only one predetermined source would satisfy those specifications." The proposed subparagraph does not provide any standard for determining whether specifications are appropriately drafted. The language is so broad and vague as to invite litigation, which would tie up even more agency resources and place the decision whether specifications are appropriately drafted in the already overburdened courts. Further, the RFP process also does not eliminate the question of whether specifications are appropriately drawn or applied when awarding a contract. Again, the ERB believes that the review and public report process outlined above would be better process for scrutinizing the sole source procurement process.

In closing, ERB is committed to a transparent and open investment procurement process. The procurement exemption repeal bill is an agenda item for the upcoming IOC meeting on December 1<sup>st</sup>. We are prepared for a more detailed discussion of the issue at that time.

Sincerely,



Jan Goodwin  
Executive Director  
New Mexico Educational Retirement Board

c.c. David Abbey, LFC  
LFC Members  
IOC Members